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No. 85-1877

In the Supreme Court of the United States

OCTOBER TERM, 1986

AZL RESOURCES, INC., PETITIONER

v.

MARGARET HALL FOUNDATION, INC., ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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QUESTION PRESENTED

Whether the alleged liability of petitioner, a corporation, for securities fraud in the circumstances of this case is primary or secondary liability and, if it is secondary, whether Section 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78t(a), precludes the application of common law vicarious liability principles to impose secondary liability on a corporation.

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

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This brief is filed in response to the Court's invitation to the Solicitor General to express the views of the United States.

STATEMENT

1. This case involves an alleged scheme to manipulate the price of the common stock of AZL Resources, Inc. (AZL), a company engaged in oil and gas exploration whose stock is listed on the American

and Pacific Stock Exchanges. The complaint,[1] whose allegations have not yet been tested at trial, asserted that senior AZL officials induced Atlantic Financial Management, Inc. (Atlantic), a registered investment adviser, to purchase AZL stock for respondents by making false and misleading statements about AZL's merger and acquisition prospects.

In particular, the complaint alleged that, beginning in April 1981, Maurice Strong, AZL's chairman, made repeated statements, both privately to Atlantic and publicly to other investment advisers and institutional investors, to the effect that AZL was actively exploring merger and acquisition possibilities (Complaint ¶¶ 30-61). The complaint further alleged that AZL issued a press release on November 6, 1981, representing that it was "actively pursuing acquisition and/or merger opportunities which would add significantly to the Company's income and prospects in the petroleum business" (Complaint ¶ 44). It also alleged that Strong made fraudulent public statements about the discovery of oil near property in which AZL had an interest (Complaint ¶ 35), as well as other fraudulent private statements (Complaint ¶ 40).

The complaint alleged that these optimistic statements about AZL's prospects induced Atlantic to purchase a substantial quantity of AZL stock for respondents in 1981 and early 1982 (Complaint ¶¶ 36, 39, 50, 51, 60). During that same period, however, several of AZL's officers and directors, as well as a 10% corporate shareholder controlled by Strong, are

[1] Six different damage actions were consolidated for the purpose of ruling on the defendants' motions to dismiss. All the complaints are substantially the same and will be referred to as "the complaint."

alleged to have sold more than 154,000 shares of AZL's outstanding securities at prices ranging from $23 to almost $29 a share (Complaint ¶ 42). In January 1982, the price of AZL's shares began to drop sharply, falling to $17.87 by February 8, 1982 (Complaint ¶¶ 55, 58). On February 9, 1982, AZL issued a second press release, which stated that "recent information * * * has caused AZL to reevaluate its position regarding potential mergers or acquisitions" (Complaint ¶ 57). By July 7, 1982, AZL stock was trading at $4.62 a share (Complaint ¶ 60).

2. The complaint as originally filed alleged that Strong, AZL, and other defendants had violated Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5.[2] AZL moved to dismiss on the ground that it could not be liable for Strong's conduct because that conduct did not benefit AZL. AZL also asserted, in the alternative, that Section 20(a) of the Exchange Act, 15 U.S.C. 78t(a), which provides that a person who "controls" any person liable under the Exchange Act is liable jointly and severally with the controlled person "unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation," provides the sole basis for secondary liability under the Exchange Act. Respondents answered, inter alia, that the corporate liability here is primary, not secondary. See C.A. App. 169-170.

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[2] The complaint also alleged (Complaint ¶¶ 62-72) that Strong and other defendants were secondarily liable for AZL's violations as "controlling persons" of AZL under Section 20(a) of the Exchange Act, 15 U.S.C. 78t(a). The complaint did not allege that AZL was a controlling person of any liable person or entity.

The district court dismissed the claim against AZL. The court asserted that "for a corporation to be held liable as a principal for the fraud of one of its officers, a party must show both that the fraud occurred in the course of the officer's employment and for the benefit of the corporation" (Pet. App. 23a). Here, the court concluded, the alleged fraudulent conduct could not have benefited AZL, so "[t]he only possible view of the facts as alleged is that the individual defendants were pursuing their own selfish ends" (*ibid.*).

Respondents then sought to amend the complaint to assert both that AZL could have benefited from Strong's activities (see C.A. App. 174-191) and that Strong acted with " 'at least apparently authority' " in conducting the fraudulent scheme (Pet. App. 30a). The court again rejected the first of these theories (*ibid.*). But it granted leave to amend the complaint to assert the apparent authority theory of liability, stating that, "[u]nder general agency principles, a corporation is liable for the fraud of its agent committed with apparent authority even if the agent's conduct was effected for his benefit alone" (*ibid.*). The court added (*id.* at 31a) that

> AZL's liability for Strong's fraud would be established by proof that Strong appeared to be acting within the scope of his authority when he disseminated allegedly false or material [*sic*] information, and that AZL had put him in a position to commit this fraud upon [respondents]. At this stage, the allegations that Strong was AZL's chairman, a position customarily allowing the officeholder to speak for and negotiate on behalf of the corporation, and that ostensibly he was pursuing the corporate goal of raising

capital, sufficiently support the assertion that Strong acted with apparent authority.

The district court subsequently denied AZL's motion for reconsideration, explaining that respondents' "allegation of Strong's apparent authority [is] legally sufficient [to establish liability] on the basis of a corporate principal's direct liability for the binding acts of its agents, not *respondeat superior*" (Pet. App. 38a). But the court did certify its order as appropriate for interlocutory appeal pursuant to 28 U.S.C. 1292(b) (Pet. App. 39a).

3. On appeal, AZL contended that apparent authority principles may only support secondary liability, and renewed its contention that a corporation may be held secondarily liable for a corporate officer's violation of the Exchange Act only under Section 20(a), 15 U.S.C. 78t(a). AZL therefore maintained that it could escape liability by demonstrating that it acted in good faith and did not induce Strong's fraudulent conduct (see AZL C.A. Br. 12-19). While AZL recognized that Section 20(a) does not come into play when the corporation's liability is primary, AZL contended that the corporation's liability is primary only when the fraud is committed for its benefit (AZL C.A. Reply Br. 3). Respondents replied that a corporation is primarily, rather than vicariously, liable for frauds committed by its agents acting within the scope of their apparent authority (C.A. Br. 8-12); respondents also contended that, even if AZL were viewed as being only secondarily liable here, Section 20(a) does not provide the exclusive vehicle for imposing vicarious liability under the Exchange Act.

Although it ruled for respondents, the court of appeals did not address their threshold contention that

AZL should be viewed as primarily, rather than secondarily, liable for Strong's alleged fraud. Instead, the court posed the issue before it as whether "the existence of [Section 20(a)] foreclose[s] holding a principal (say, a corporation) or an employer (who 'controls' an agent or employee) 'vicariously liable' when the proviso's two conditions [that the controlling person acted in good faith and did not directly or indirectly induce the violation] are not met" (Pet. App. 4a). The court answered this question by holding that "section 20(a) does not constitute an exclusive substitute for vicarious liability that might otherwise exist" (*ibid.*), "at least in respect to the common law 'apparent authority' theory here at issue" (*id.* at 5a). Looking to the legislative history and background of Section 20(a), the court of appeals concluded that the provision was not intended to displace common law liability (Pet. App. 9a-15a).

DISCUSSION

As posed by AZL, the question in this case is whether Section 20(a), which makes a "controlling person" liable for the violations of a controlled person but gives the controlling person a good faith defense, precludes the application of common law vicarious liability principles to hold a corporation liable for its agent's violations of the Exchange Act. That question is a significant one, and one on which the circuits are divided. In our view, however, that question is not squarely presented in this case. To the contrary, respondents' complaint alleges, and makes out a colorable claim, that AZL is directly or primarily, rather than vicariously or secondarily, liable for the fraud at issue here. In these circumstances, review of the interlocutory decision below—

which, like the petition, fails to address the possibility of primary liability in this case—may not provide this Court with an opportunity to decide whether Section 20(a) displaces common law principles of vicarious liability.

1. The United States has previously urged the Court to decide whether Section 20(a) provides the exclusive remedy against controlling persons and precludes holding a corporation vicariously liable on common law theories for its agent's violations of the Exchange Act. 80-2211 U.S. Br., *Smith Barney, Harris, Upham & Co.* v. *Henricksen.* The circuits are divided on this question, which arises with considerable frequency. The majority view—adopted by the Second, Fifth, Sixth, Seventh, Eighth, Tenth, and now the First Circuits—is that common law agency principles apply in cases brought against corporations and other employers under the securities laws.[3] The Ninth Circuit, on the other hand, has held that agency principles are inapplicable in such cases, so that the liability of employers for the fraudulent acts of their employees must be determined exclusively by application of the controlling-person provisions contained in Section 20(a) of the Exchange Act and in the parallel Section 15 of the Securities

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[3] See, *e.g.*, *Marbury Management, Inc.* v. *Kohn*, 629 F.2d 705 (2d Cir.), cert. denied, 449 U.S. 1011 (1980); *SEC* v. *Management Dynamics, Inc.*, 515 F.2d 801, 812-813 (2d Cir. 1975); *Paul F. Newton & Co.* v. *Texas Commerce Bank*, 630 F.2d 1111 (5th Cir. 1980); *Holloway* v. *Howerdd*, 536 F.2d 690, 694-695 (6th Cir. 1976); *Armstrong, Jones & Co.* v. *SEC*, 421 F.2d 359, 362 (6th Cir.), cert. denied, 398 U.S. 958 (1970); *Henricksen* v. *Henricksen*, 640 F.2d 880 (7th Cir.), cert. denied, 454 U.S. 1097 (1981); *Fey* v. *Walston & Co.*, 493 F.2d 1036, 1052 (7th Cir. 1974); *Commerford* v. *Olson*, 794 F.2d 1319 (8th Cir. 1986); *Kerbs* v. *Fall River Industries*,

Act, 15 U.S.C. 77o.[4] The Third Circuit has also held that as a general matter the liability of a principal under the securities laws may not be grounded on respondeat superior, although it has recognized an exception to this rule in cases involving accounting and broker-dealer firms.[5]

2. The question whether Section 20(a) precludes other theories of secondary liability arises, however, only when the plaintiff seeks to impose liability on the corporate principal vicariously, for the acts of its agents, rather than directly for its own acts. Congress plainly intended corporations to be directly and primarily liable under the securities laws for violative conduct that constitutes an act of the corporation itself. In particular, a corporation can plainly be held directly liable for *its* misstatements: Section 10(b) of the Exchange Act makes it unlawful for any "person" to engage in fraudulent conduct, and the term "person" is in turn defined in Section 3(a)(9), 15 U.S.C. 78c(a)(9), to include a "com-

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Inc., 502 F.2d 731, 741 (10th Cir. 1974). The Fourth Circuit appears to have adopted this approach as well. See *Johns Hopkins University* v. *Hutton*, 422 F.2d 1124, 1130 (1970), cert. denied, 416 U.S. 916 (1974); *Carras* v. *Burns*, 516 F.2d 251, 259, 261 (1975). But see *Carpenter* v. *Harris, Upham & Co.*, 594 F.2d 388 (4th Cir.), cert. denied, 444 U.S. 868 (1979). Compare *Frankel* v. *Wyllie & Thornhill, Inc.*, 537 F. Supp. 730 (W.D. Va. 1982), with *Haynes* v. *Anderson & Strudwick, Inc.*, 508 F. Supp. 1303 (E.D. Va. 1981).

[4] See *Zweig* v. *Hearst Corp.*, 521 F.2d 1129 (9th Cir.), cert. denied, 423 U.S. 1025 (1975); *Kamen & Co.* v. *Paul H. Aschkar & Co.*, 382 F.2d 689, 696-697 (9th Cir. 1967), cert. dismissed, 393 U.S. 801 (1968).

[5] See *Sharp* v. *Coopers & Lybrand*, 649 F.2d 175 (3d Cir. 1981), cert. denied, 455 U.S. 938 (1982); *Rochez Bros.* v. *Rhoades*, 527 F.2d 880 (3d Cir. 1975).

pany." Other provisions, including Sections 13(a), 15 and 17, 15 U.S.C. (& Supp. III) 78m(a), 78o and 78q, impose obligations upon "issuers," "brokers" and "dealers," which often are corporate entities.[6] Indeed, AZL recognizes that corporations may be deemed *directly* liable under the securities laws for certain acts of their employees that were not expressly authorized or ratified by the shareholders.[7]

Several courts, including this Court[8]—and includ-

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[6] The legislative history of the Exchange Act demonstrates that it was designed in large part to curb abuses committed by corporations and other entities. See S. Rep. 792, 73d Cong., 2d Sess. 10 (1934) (corporate reports); *id.* at 12 (proxy statements); *id.* at 11-12 (brokerage firms); S. Rep. 1455, 73d Cong., 2d Sess. 68-74 (1934) (corporate reports); *id.* at 74-77 (proxy statements); *id.* at 163-221 (investment banking); *id.* at 333-384 (holding companies). The Securities Act of 1933, 15 U.S.C. (& Supp. III) 77a, requires a registration statement to be signed by the issuer (§ 6, 15 U.S.C. 77f), and makes each signer liable for any material misstatement of fact therein (§ 11, 15 U.S.C. 77k). It was a central purpose of both the Securities Act and the Exchange Act to impose disclosure obligations (and liabilities) directly on the issuer of the securities. See Cohen, *"Truth in Securities" Revisited*, 79 Harv. L. Rev. 1340, 1346, 1361 (1966).

[7] Before the court of appeals, AZL argued that a corporation is directly liable under Section 10(b) for the acts of its employees when those acts are committed for the corporation's benefit. See AZL C.A. Reply Br. 5.

[8] See, *e.g.*, *Herman & MacLean* v. *Huddleston*, 459 U.S. 375 (1982) (accounting firm's certification of balance sheet in case involving Section 10(b)); *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375 (1970) (false proxy materials in case under Section 14(a), 15 U.S.C. 78n(a)); *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968) (en banc), after remand, 446 F.2d 1301, 1304-1306 (2d Cir.), cert. denied, 404 U.S. 1005 (1971) (misleading press release in Section 10(b) case).

ing the Ninth Circuit,[9] which has rejected "vicarious" corporate liability under the securities laws—have held corporations liable under Section 10(b) and other provisions of the securities laws, in cases where false statements or documents were issued in the corporation's name, without any suggestion that the liability of the corporation was merely derivative of the liability of another person. And the Third Circuit, which also has generally rejected Section 10(b) "vicarious" liability, has held that corporations may be "primarily" liable when the misconduct is that of a senior officer: "[H]igh ranking officers in a corporation, or partners in a partnership, present a different situation from lower level employees. Officers are able to make policy and generally carry authority to bind the corporation. Their action on behalf of the corporation is therefore primary, and holding a corporation liable for their actions does not require respondeat superior." *Sharp* v. *Coopers & Lybrand*, 649 F.2d 175, 182 n.8 (3d Cir. 1981), cert. denied, 455 U.S. 938 (1982). See also *Holmes* v. *Bateson*, 583 F.2d 542, 561 (1st Cir. 1978).[10]

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[9] See *SEC* v. *Goldfield Deep Mines Co.*, 758 F.2d 459 (9th Cir. 1985) (false registration statement in case involving 15 U.S.C. 78*l*(g)); *SEC* v. *Blazon Corp.*, 609 F.2d 960 (9th Cir. 1979) (false offering circular in case involving Section 17(a) of the Securities Act); *Marx* v. *Computer Sciences Corp.*, 507 F.2d 485 (9th Cir. 1974) (inflated earnings projection in case involving Section 10(b) of the Exchange Act).

[10] This conclusion draws some support from the treatment of corporate directors under the common law. Directors "are not agents since they are the controllers rather than the controlled * * *. Their position makes them sui generis in the hierarchy of legal conceptions." W. Seavey, *Handbook of the Law of Agency* § 10, at 18-19 (West 1964). See also Restatement (Second) of Agency § 14C (1958). Because

To be sure, corporate conduct invariably involves one or more human actors. But a false statement can be the act of a corporation (although a human actor is required), just as a promissory note can be the act of a corporation, and in either case the liability thereon is direct and not derivative, so there is no need to rely on *either* common law vicarious liability principles *or* a statute imputing liability, as Section 20(a) imputes liability to controlling persons. There may, of course, be a question whether a given action *is* the act of the corporation, but where the answer to that question is yes, there is no occasion to determine which theories of vicarious liability may be valid and available.

In the present case respondents have made a colorable claim of primary liability on the part of AZL, as the district court recognized (see Pet. App. 38a). AZL issued a misleading press release in its own name. Compare *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833, 845, 861 (2d Cir. 1968) (en banc), after remand, 446 F.2d 1301, 1304-1306 (2d Cir.), cert. denied, 404 U.S. 1005 (1971). The fraud here, moreover, was conducted largely by AZL's chairman, who issued public statements and dealt with investors on AZL's behalf. And respondents asserted below that the fraud was committed for AZL's benefit;[11] while the district court rejected that contention (see Pet. App. 23a, 30a), it did not consider whether such a benefit is necessary to create primary liability. Respondents' argument also has not been

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such officials control the corporation, it is entirely fictitious to view their actions as anything other than the actions of the corporation.

[11] Respondents repeat that assertion before this Court. See Br. in Opp. 4 n.2.

addressed by the court of appeals, which evidently viewed the issue as outside the question certified for interlocutory appeal.

In these circumstances, review of the decision below is not justified. Because AZL's liability here may be primary, resolution of the question presented in the petition—whether Section 20(a) precludes common law vicarious liability under the Exchange Act—may be irrelevant to the outcome of this case. Indeed, before reaching the question presented, the Court would have to decide whether the liability alleged is primary or secondary, an issue that is not addressed by the petition, was not discussed by the court of appeals here, and has not yet been analyzed in depth by other courts of appeals. Its consideration by this Court in this case accordingly would be premature.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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